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Monthly Letter on Economic Conditions Government Finance

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General Business Conditions

TRADE and industrial reports have made another strong showing during March. The principal manufacturing industries, with a few exceptions where over-capacity is chronic, are producing all they can and shipping all they make. Many are operating against large unfilled orders, while others take an optimistic view of spring prospects and are stocking their distributors accordingly. In the aggregate, the country could hardly be busier than it now is, for in a good many areas production is up against the ceiling of the labor supply or of plant capacity, and a few industrial materials are still scarce. The pressure on the steel mills is unabated. Some significant increases in new orders, as for machine tools, have been reported, and for the industries as a whole incoming business, together with backlogs, assures a high production rate for a considerable time to come.

Retail sales continue good. Total retail trade in February was better than in January on a seasonally adjusted basis, and exceeded last year's figure by 7 per cent. Department store sales in March have been encouragingly higher than a year ago, even after allowance for the earlier Easter this year. These increases are the more impressive because they are occurring without any special stimulus to "scare" buying, such as the fears of shortages and higher prices which followed the outbreak of the Korean war. In the present circumstances, people look forward to abundant supplies and probably—in some things—lower prices. Thus good retail sales are attributable to high employment, high personal incomes, and willingness to buy and, if necessary, to borrow to finance major purchases.

CONTENTS

Business and Consumer Spending High

The conditions which influence the willingness of people to spend, and also to borrow for the purpose of spending, at any given time may include the level of income received and in prospect, holdings of liquid savings, and expectations as to employment and prices. A survey made for the Board of Governors of the Federal Reserve System, whose findings were published during the month, indicates that the current outlook is favorable in all these respects. It shows, for example, that 48 per cent of the spending units surveyed are receiving higher incomes than a year ago, and that 36 per cent expect to have further increases during the next twelve months. More expect to buy new cars and major household goods this year than did a year or two years ago, and slightly more expect to purchase new or existing houses. Those who feel that times are good for making major purchases of durable goods total 33 per cent compared with 22 per cent last year. If these attitudes hold over the coming months, and are translated into equivalent buying, business in consumer items will continue active.

Another significant statistical report indicates that plant expansion and improvement, making demands on the construction and equipment in-

dustries, are still going forward at a record rate. Toward the end of last year the Department of Commerce and the Securities and Exchange Commission reported that expenditures for these purposes in 1953 would drop 2 per cent below the 1952 total. A later survey, published in March, indicates an increase of 2 per cent. These figures are not guesswork, but a compilation of actual intentions to spend as reported by corporations. The increase is not large in amount, but it is significant that the tendency has been to enlarge programs rather than contract them, and that 1953 promises again to break all records. Construction contracts still run above a year ago. Local governments add a record-breaking volume of projects to the overall demand, and defense expenditures spread their support throughout the economy.

The Inventory Question

All this adds up to new high records for such measures of economic welfare as industrial production, employment, and personal incomes. The area in which statistical information necessarily lags, and which is now becoming of acute interest, is the state of inventories. If it were certain that the record-breaking output of the mills and factories was being fully absorbed, that fact might be proof of a reasonably good balance in the economy.

On the other hand, some elements in the situation are characteristic of the top of the cycle. Debt has risen and credit has tightened. Production is pressing against capacity and labor is making new demands. Costs tend to rise, prices of some things have firmed while farm prices have dropped, and profit margins have narrowed. Any weaknesses that develop will be reflected in accumulation of goods. Moreover, the state of sentiment, which affects buying policy, can change rapidly. As this Letter goes to press, stock and commodity prices are weak on the renewed possibility of a Korean armistice. Whatever the outcome, the weakness provides a fresh reminder of the uncertainties always present in the international situation.

To a great extent the evidence on inventories so far is reassuring. Merchants are buying conservatively and emphasizing turnover, and a good share of the apparently high manufacturers' inventories consists of materials and work in process held against defense orders. However, in automobiles and some other consumers' durable goods a policy of building dealers' stocks is being followed, as manufacturers strive to get the greatest possible share of expected good spring sales.

It is also plain that, although steel is still in great demand, steel stocks have been replenished at least in part since the low point was reached during the strike. In some degree this applies in many lines. When foreign supplies of lead and zinc broke the markets, domestic stocks were quickly shown to be larger than had been believed.

The question to which business men are now seeking an answer, which they can hardly obtain at the moment, is whether the output in prospect this spring will in fact be absorbed and high operating rates sustained by sales, or whether the markets are being temporarily over-crowded. The answer, when it comes, will throw light on the probable level of productive activity in the latter part of the year. Meanwhile, the strong support to be expected from business expenditures on plant and equipment, from construction, and from defense work creates a presumption that employment, and the resulting flow of purchasing power through the economy, will continue high.

Credit Policy

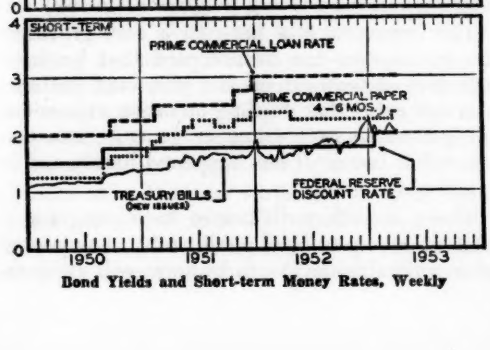
Business volumes, as noted, developing beyond earlier anticipations, are pressing against the limitations of labor supply, requiring overtime operations in a number of the industries, firming the raw material markets, and giving impulse to further advance in industrial costs. While many observers hold to the expectation of a business reaction later in the year, others are expressing concern over the risk that a broad trend of rising prices may ensue, in the natural sequence, reawaken fears of continuing losses in the value of the dollar, and stimulate an inventory accumulation cycle which, unchecked, could build up to a later and bigger drop. It is worthy of note that only the good 1952 crops and record livestock production, bringing lower retail prices of food, prevented the cost of living index this past winter from breaking into new high ground.

The current business surge is dependent, marginally, on the spending of borrowed money; and the associated credit demands have tightened the money market, firmed money rates, and depressed bond prices to new lows for the postwar period. Foreign gold withdrawals, in progress since December, and borrowings by corporations to help cover their heavy March 15 tax payments, have played parts bringing pressure on the credit supply. But the main seats of pressure at the present time are the volume of bond flotations, actual and prospective, and the demands for mortgage and consumer financing.

April and May are months of seasonal reduction in bank loans to business but the developing expectation is that the Treasury, entering the market for deficit-financing, will absorb any slack that appears.

As the chart indicates, yields on corporate bonds, which held comparatively stable during 1952, have risen about ⅛ per cent on the average since the year-end. State and municipal bonds, which suffered major readjustments in August-September and February, now yield on the average nearly ¼ per cent more than at the year-end and a full ½ per cent more than in March, 1952. Twenty-year U.S. government bonds, paying 2½ per cent, traded during the last week of March as low as 93⅛, down 2⅜ points from the year-end and 3½ points from the level prevailing a year ago; the yield to a buyer has risen from 2.70 per cent a year ago and 2.79 per cent at the year-end to 2.94 per cent.

Apart from the general pressure of credit demands, the decline in long-term governments during March represented an adjustment to reports that the new Administration was considering tapping the long-term market for a part of the funds required to finance the current deficit and meet maturities of Series F and G Savings bonds. The general assumption in the market is that it will take a 3¼ per cent rate to attract much buying interest against the competition of the mortgage, corporate and municipal bond markets. The market for long-term governments has been conspicuously thin; offerings have been limited by the reluctance of holders to accept losses and broad buying interest has been discouraged by the unattractive yields available.



Bond Yields and Short-term Money Rates, Weekly

In the mortgage market many lenders are shifting emphasis toward conventional mortgages paying 4½ per cent or better and away from the 4¼ per cent F.H.A. insured mortgage. Veterans' mortgages paying 4 per cent can be placed only at considerable discounts. Among short-term money rates, the minimum rate on prime 4-6 months' commercial paper was moved up ⅛ to 2⅜ per cent during March. The banks' prime commercial loan rate, unchanged at 3 per cent since December, 1951, has become more selective.

Demand Excessive to Supply

The accumulation of insurance company and pension reserves and a rising trend of savings deposits give large resources for the absorption of bonds and mortgages. Nevertheless, the pace of credit demand is excessive to the supply. For example, State and local governments have been borrowing at double the rate of early 1952. No one expects such a rate to be sustained; nevertheless, a year's total surpassing the record $4 billion figure for 1952 seems to be assured by prospective bond issues to finance highway and turnpike construction, subsidized housing, school, and other building programs. Corporate bond issues have set out at a rate which, for the full year, could produce a total rivalling the record $7.7 billion 1952 figure.

The individual citizen is also a heavy borrower, principally for home building, fitting up his home, and getting a new car. With the end of real estate credit regulations last September, and the open winter along the heavily-populated Eastern seaboard, mortgage credit demands have been developing strongly and another $6 billion expansion in mortgage indebtedness on urban homes appears to be shaping up. There are signs of stringency in the supply of mortgage funds, and acquisitions of mortgages by the Federal National Mortgage Association ("Fannie Mae") have been slowed to reduce the burden on the Federal budget; otherwise an even larger figure might be in the making. Consumer instalment credit, freed from regulation last spring, has been expanding at a rate of $3½ billion or 26 per cent a year. This expansion is a key element in the strength of demands for automobiles and household equipment.

The Danger

The question many people ask is, if business is so good why do anything to disturb it? The instalment credit figures give an illustrative answer. Unless incomes — and with them prices — are constantly inflated, the buildup in indebtedness claims a rising share of the consumer's income, subjecting his spending to more rapid curtail-

ment when adversity strikes. While consumer instalment indebtedness today is no more than 6.8 per cent of total personal incomes after tax — a figure that was equalled in 1941 — a rising percentage measures a rising vulnerability to collapse of buying. The problem of public policy is to spread prosperity out in time, not to let optimism carry to excess and burn itself out in a speculative spree. This applies to the whole area of credit which, because of its fluidity and elasticity, is easily subject to abuse.

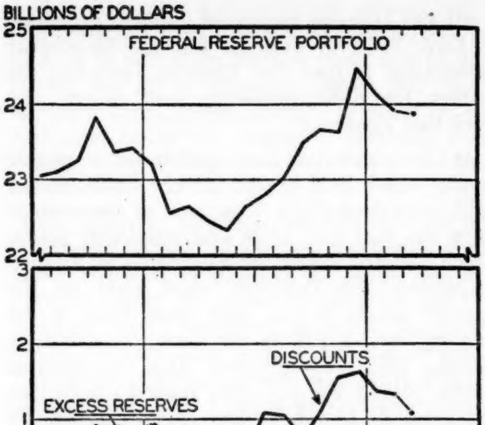
The obvious remedy lies in tightening up the supply of credit. The government can achieve this directly as far as its own credit-granting agencies are concerned. The curtailment of "Fannie Mae's" activities, and the decision to let the Reconstruction Finance Corporation expire, are constructive moves toward this end. Apart from such measures, brakes can be applied through discount rate advance and public debt reconstruction.

Discount Rate

The last adjustment in the Federal Reserve discount rate — a ¼ per cent advance to 2 per cent in January — was not so much designed to tighten the credit supply as to bring the rate into more realistic alignment in the structure of rates that had developed under the force of credit demands. Also in January, as is customary, the Federal Reserve authorities allowed their government security holdings — swollen to a new peak of $24¾ billion during the December money pinch — to run down to the extent of $750 million, offsetting most of the gains to bank reserves from seasonal return of currency from circulation. In February and March they pared their government portfolio slightly further to $23.8 billion. In the third week of March, the Treasury borrowed $333 million direct from the Federal Reserve on special series certificates of indebtedness but these borrowings were repaid by the month-end.

Under this "neutral" open market policy, expanded credit demands, along with gold outflow, have exerted their natural influence of keeping the credit markets under pressure. As a result, member bank borrowings from the Federal Reserve have been maintaining an average above $1 billion.

The discount facility, as is its purpose, gives flexibility to the supply of credit. Over-ready recourse to borrowing can be countered by discount rate increase. In the existing situation there is little question but that such action would have some jolting effect on the money and capital market and give reason to borrowers to reappraise expansion and financing plans. The authorities will have to consider whether the situation is one in which a cautioning jolt would be in the best interests of the nation.



Federal Reserve Holdings of Government Securities and Member Bank Excess Reserves and Discounts (Monthly averages of daily figures)

Funding Public Debt

Another ready weapon lies in the Administration's program of extending part of the public debt over longer periods and gradually placing larger amounts in the hands of longer-term investors. When President Eisenhower announced this program in his State of the Union message, February 2, he indicated that the program would be undertaken "at suitable times". The question arises: what is a suitable time?

Putting out long-term Treasury bonds is apt to be easiest and also cheapest in a time of business recession when credit demands are light and savings institutions have trouble finding suitable outlets for their funds. Many observers have been anticipating a period of easing in business volume and credit demand in the second half of this year and believe the Treasury can save money on interest charges by awaiting such a period to get a funding program under way.

The argument is a persuasive one, provided the assumption can be accepted that business will turn downward on the projected pattern. The risk exists that, feeding on credit expansion, rising business optimism may generate into uncontrolled boom. It has happened before and it can happen again.

There are other difficulties in waiting for a business slump to fund public debt. Any period of considerable decline in business will bring an

exaggerated drop in government revenues, since those revenues depend so heavily on the incomes which business activity generates. The paramount need for deficit-financing might not permit prosecution simultaneously of a program of funding debt. Moreover, at such a time a funding program, vigorously pursued, would soak up funds available to take up mortgages and corporate and municipal bonds and thus might interfere with the processes of recovery.

An alternative is to consider such a time as the present suitable at least to get started on debt funding, notwithstanding the difficulties of swimming upstream and putting out securities in a market that already is being abundantly supplied. It will require higher interest rates than the Treasury has been used to paying – and higher than may be necessary for debt funding at some later point of time. On the other hand, current rates are low rather than high by the standard of the longer stretch of history, and a competitive rate is the only one that can induce the buyer to take a U.S. government obligation in preference to other types of securities.

Some fear that reentrance of the Treasury into the long-term investment market will have a constrictive effect on the supplies of funds available for the mortgage, corporate, and municipal bond markets. Yet this is the most cogent reason for getting under way with a program. Scaled with moderation to avoid provoking an undue stringency of funds for other purposes, it can make a contribution to economic stability and force a deferral into the future of projects which the economy will be able to handle later on with benefit instead of risk to economic stability.

Corporate Earnings in 1952

Annual reports for the year 1952 published during the past month by some 1,200 additional corporations confirm the trends indicated by the preliminary summary in our March issue. Figures now available for 3,440 corporations give combined net income of approximately $12.6 billion after taxes, compared with $12.9 billion in 1951, a decrease of 2 per cent. About 54 per cent of the companies that reported had decreases, against 46 per cent with increases.

Among the major divisions of business, there were decreases in net income in the group totals for manufacturing, mining, trade, and service companies, but increases for the transportation, public utility, and financial companies.

Dollar sales last year surpassed those of 1951 in most cases, and in many established new all-time records. Due largely to a continued advance in operating costs, however, there developed a widespread squeezing of net profit margins. The 1952 sales or revenues of all companies in our tabulation, excluding banks and other financial institutions, aggregated around $200 billion and were slightly above the total of 1951. The average margin of net profit, however, was cut from 6.2 to 5.6 cents per sales dollar. This margin was narrowed in 53 out of the 65 major industry classifications.

Changes by the main divisions of business are given below, while the more detailed summary by industry groups appears on the next page.

Net Income of Leading Corporations for the Years 1951 and 1952

(In Millions of Dollars)

No. of Cos.	Industry Divisions	Net Income after Taxes 1951	Net Income after Taxes 1952	Per Cent Change	% Margin on Sales 1951	% Margin on Sales 1952
1,788	Manufacturing	$ 8,716	$ 8,098	— 7	6.2	5.4
68	Mining, quarrying	183	158	—14	9.7	7.8
194	Trade (ret. & whol.)	600	554	— 8	2.7	2.4
246	Transportation	819	961	+17	6.4	7.8
306	Public utilities	1,367	1,533	+12	11.9	12.1
114	Amusements, services	139	131	— 5	4.5	4.5
724	Banks and finance	1,051	1,183	+13	—	—
3,440	Total	$12,875	$12,612	— 2	6.2	5.6

These 3,440 companies had net assets or net worth amounting to $122.3 billion at the beginning of 1952, upon which the year's net income represented an average return of 10.3 per cent. This was moderately below the 11.4 per cent average rate realized in 1951 on net assets of $112.9 billion, and the lowest shown by our annual tabulations since 1946 when the average was 9.5 per cent.

Throughout the postwar years the rates of return computed on net assets have tended to overstate the real rates of earnings, for the reason (among others) that plant and equipment is usually carried on the balance sheets at original cost less depreciation, which is below replacement cost. Although the vast expenditures by business year after year since 1945 for modernization and expansion of physical properties have raised property valuations so as to reflect replacement costs more realistically, there is a substantial lag in this process of adjusting book values to current values. Much business property is written down for accounting and tax purposes on the basis of a 20-year, 25-year, or even longer life.

Both the rates of return on net assets and net profit margins on sales as computed in the table are widely-used measures of earnings, which properly should be considered together. Because of the variation among different lines of business in the rates of capital turnover – expressed by the ratio of annual sales to capital funds – a wide profit margin per sales dollar does not necessarily mean a high rate of return on capital. Nor does a narrow profit margin necessarily

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1951 AND 1952

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1951	Reported Net Income After Taxes 1952	Per Cent Change†	Book Net Assets Jan. 1 -a 1951	Book Net Assets Jan. 1 -a 1952	% Return on Net Assets -a 1951	% Return on Net Assets -a 1952	% Margin on Sales -b 1951	% Margin on Sales -b 1952
22	Baking	$ 51,668	$ 52,934	+ 2	$ 420,750	$ 434,855	12.3	12.2	3.5	3.6
16	Dairy products	67,214	67,117	—	611,720	637,815	11.0	10.5	2.2	2.1
18	Meat packing	46,133	32,974	—29	850,220	860,773	5.4	3.8	0.6	0.4
19	Sugar	58,866	42,537	—28	487,069	507,205	12.1	8.4	6.2	4.4
79	Other food products	223,061	196,541	—12	1,897,172	1,972,298	11.8	10.0	3.6	3.1
15	Soft drinks	38,627	38,913	+ 1	306,269	318,960	12.6	12.2	8.7	7.7
27	Brewing	35,564	33,744	— 5	305,711	323,811	11.6	10.4	4.7	4.2
12	Distilling	120,912	83,208	—31	936,256	1,073,024	12.9	7.8	5.0	3.6
23	Tobacco products	119,477	114,073	— 5	1,215,273	1,246,217	9.8	9.2	3.9	3.4
37	Cotton goods	92,767	44,730	—52	769,472	837,058	12.1	5.3	5.6	2.9
13	Silk and rayon	69,230	43,934	—37	594,515	668,884	11.6	6.6	9.0	6.7
9	Woolen goods	16,993	*D-7,201*	—	220,355	228,157	7.7	— *3.2*	3.0	— *2.4*
18	Hosiery, knitted goods	16,239	8,890	—45	154,265	169,847	10.5	5.2	5.1	3.0
9	Carpets, floor coverings	12,442	16,716	+34	262,411	271,262	4.7	6.2	1.9	3.4
39	Other textile products	96,470	49,762	—48	815,357	885,610	11.8	5.6	4.9	2.5
34	Clothing and apparel	20,895	17,653	—16	277,116	286,399	7.5	6.2	3.0	2.6
31	Shoes, leather, etc.	31,307	27,239	—13	331,944	340,765	9.4	8.0	3.0	2.6
26	Tires, rubber products	180,562	165,059	— 9	1,100,491	1,234,211	16.4	13.4	4.3	3.9
25	Lumber	98,088	77,849	—21	611,396	675,003	16.0	11.5	9.7	8.0
15	Furniture, wood products	11,250	10,041	—11	85,759	90,805	13.1	11.1	4.5	3.9
79	Paper and allied products	335,585	284,707	—15	2,083,301	2,338,149	16.1	12.2	8.8	7.3
37	Printing and publishing	39,280	37,122	— 5	331,341	334,776	11.9	11.1	4.6	4.0
64	Chemical products	628,332	592,324	— 6	3,860,327	4,327,261	16.3	13.7	9.9	7.7
20	Drugs and medicines	110,025	96,330	—12	552,881	686,841	19.9	14.0	9.4	8.4
16	Soap, cosmetics, etc.	73,213	64,094	—12	480,104	510,298	15.2	12.6	5.5	4.8
20	Paint and varnish	57,389	51,453	—10	443,212	479,772	12.9	10.7	4.7	4.3
91	Petroleum prod. & refining	2,247,118	2,172,405	— 3	13,540,717	14,998,992	16.6	14.5	11.5	10.5
33	Cement	53,654	57,279	+ 7	370,928	405,799	14.5	14.1	11.8	11.9
13	Glass products	91,442	95,322	+ 4	602,957	649,899	15.2	14.7	6.8	7.1
48	Other stone, clay products	125,994	113,420	—10	847,301	916,733	14.9	12.4	8.1	7.5
53	Iron and steel	691,946	539,015	—22	5,611,797	6,139,915	12.3	8.8	5.8	5.0
12	Agricultural implements	161,540	158,249	— 2	1,360,021	1,450,772	11.9	10.9	5.4	5.3
70	Building, heat., plumb. equip.	123,819	105,925	—14	897,381	981,439	13.8	10.8	5.5	4.4
78	Electrical equip., radio & tv.	399,067	417,909	+ 5	2,496,611	2,828,279	16.0	14.8	5.2	4.6
49	Hardware and tools	50,904	45,420	—11	388,191	420,560	13.1	10.8	6.1	5.1
46	Household appliances	66,444	67,157	+ 1	514,736	552,403	12.9	12.2	4.9	4.5
177	Machinery	254,221	264,002	+ 4	1,709,889	1,865,790	14.9	14.1	5.9	5.0
29	Office equipment	105,251	97,938	— 7	622,956	686,894	16.9	14.3	7.4	6.3
39	Nonferrous metals	370,990	336,874	— 9	2,739,352	2,917,215	13.5	11.5	8.8	7.7
106	Other metal products	213,709	179,380	—16	1,429,594	1,570,801	14.9	11.4	5.2	4.1
24	Autos and trucks	636,583	699,018	+10	3,617,356	3,783,904	17.6	18.5	5.2	5.5
68	Automobile parts	191,399	173,473	— 9	1,220,145	1,317,999	15.7	13.2	4.5	4.0
26	Railway equipment	82,981	78,777	— 5	854,211	884,200	9.7	8.9	4.8	3.8
33	Aircraft and parts	62,679	124,876	+99	686,747	709,055	9.1	17.6	2.2	2.4
8	Shipbuilding	12,183	13,082	+ 7	113,512	120,905	10.7	10.8	4.0	2.9
67	Misc. manufacturing	122,474	110,419	—10	971,302	1,048,115	12.6	10.5	6.3	5.4
1,788	Total manufacturing	8,715,987	8,092,683	— 7	60,600,391	65,989,725	14.4	12.3	6.2	5.4
29	Coal mining -c	61,941	47,977	—23	690,437	725,948	9.0	6.6	5.5	4.1
28	Metal mining -c	81,008	67,960	—16	565,394	662,685	14.3	10.3	13.2	10.5
11	Other mining, quarrying -c	40,187	41,661	+ 4	155,739	171,527	25.8	24.3	24.0	23.7
68	Total mining, quarrying	183,136	157,598	—14	1,411,570	1,560,160	13.0	10.1	9.7	7.8
24	Chain stores—food	58,352	56,183	— 4	497,037	526,931	11.7	10.7	1.1	1.0
53	Chain stores—variety, etc.	131,158	121,627	— 7	1,221,701	1,271,821	10.7	9.6	3.7	3.3
54	Department and specialty	143,374	137,900	— 4	1,467,060	1,540,377	9.8	9.0	2.7	2.5
7	Mail order	171,682	163,654	— 5	1,299,452	1,381,308	13.2	11.8	4.2	3.8
56	Wholesale and miscellaneous	94,979	74,280	—22	735,583	784,819	12.9	9.5	2.5	2.1
194	Total trade	599,540	553,644	— 8	5,220,833	5,505,256	11.5	10.1	2.7	2.4
131	Class 1 railroads -d	691,342	824,471	+19	14,439,447	14,867,836	4.8	5.5	6.7	7.8
36	Traction and bus	19,338	21,507	+11	507,844	504,984	3.8	4.3	2.5	3.1
12	Shipping	31,837	31,985	+ —	302,941	317,310	10.5	10.1	7.5	7.8
21	Air transport	55,904	59,900	+ 7	342,293	383,905	16.3	15.6	5.6	5.3
46	Misc. transportation	20,754	23,174	+12	265,937	271,775	7.8	8.5	6.7	6.4
246	Total transportation	819,175	961,087	+17	15,858,462	16,345,810	5.2	5.9	6.4	7.3
243	Electric power, gas, etc. -d	958,210	1,079,146	+13	10,667,931	11,622,144	9.0	9.3	13.1	13.3
63	Telephone and telegraph -d	409,133	453,736	+11	4,584,866	5,391,223	8.9	8.4	9.9	9.9
306	Total public utilities	1,367,343	1,532,882	+12	15,252,797	17,013,367	9.0	9.0	11.9	12.1
21	Amusements	50,262	41,105	—18	678,823	658,962	7.4	6.2	4.3	4.2
39	Restaurant and hotel	8,510	10,305	+21	135,743	139,658	6.3	7.4	3.3	3.2
33	Other business services	55,811	51,402	— 8	341,629	375,484	16.3	13.7	6.6	5.9
21	Construction	24,422	28,565	+17	175,021	189,949	14.0	15.0	2.3	3.9
114	Total amusements, services, etc.	139,005	131,377	— 5	1,331,216	1,364,053	10.4	9.6	4.5	4.5
315	Commercial banks	512,110	552,708	+ 8	6,223,992	6,580,211	8.2	8.4	—	—
68	Fire and casualty insurance	120,161	168,683	+40	2,159,063	2,300,602	5.6	7.3	—	—
186	Investment trusts -e	254,508	285,388	+12	3,782,698	4,446,074	6.7	6.4	—	—
68	Sales finance companies	144,825	147,317	+ 2	888,136	943,883	16.3	15.6	—	—
87	Real estate companies	18,989	28,788	+52	210,981	219,593	9.0	13.1	—	—
724	Total finance	1,050,593	1,182,884	+13	13,264,870	14,490,363	7.9	8.2	—	—
3,440	Grand total	$12,874,779	$12,612,105	— 2	$112,940,139	$122,268,734	11.4	10.3	6.2	5.6

a—Book net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent over nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures in most cases exclude capital gains or losses on investments. † Increases or decreases of over 100% not computed. D—Deficit.

mean a low return. This is shown in the large table giving both percentages by industries.

When a company is able to turn over its capital several times each year, a narrow profit margin on all the business transacted may yield sufficient income to provide a fair return to shareholders, with something left over to finance growth. For example, the group of 24 leading grocery chains reporting for last year sold some $5.7 billion, upon which they made an average profit of only 1.0 cent per dollar of sales, but this represented a 10 per cent return on their net book value. Although last year's profit margin of the food chains was somewhat narrower than usual, because of a squeeze on many items between rising costs and fixed selling prices, their long-term record in our annual tabulations over the twenty years 1933-52 shows an average net margin of only 1.4 cents per sales dollar. The traditionally thin margins earned for the mass distribution of food (and processing also, in many cases) are acceptable only because of the high rates of turnover.

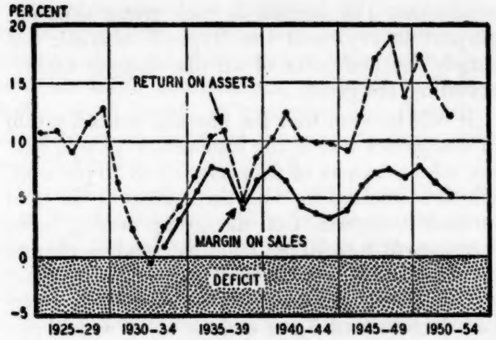
Manufacturers' Sales and Earnings

In the manufacturing industries, which in number of companies and in net assets comprise in our tabulation over half of the grand total for all lines, the combined net income of the 1,788 companies was approximately $8.1 billion last year, a decrease of 7 per cent from 1951. About 69 per cent of the companies had decreases, against 31 per cent with increases.

Combined sales, totaling around $150 billion, were 5 per cent higher than in the preceding year, but total costs, except taxes, rose by 9 per cent, so that the balance before taxes declined by 15 per cent. This cut sharply the amount of income subject to the excess profits tax (plus the normal tax and surtax) at the top rate of 82 per cent, and total federal tax liability dropped by 22 per cent. Such taxes last year still took 52 per cent — more than half — of the income before taxes, compared with 57 per cent taken the year before.

The longer-term trend of earnings of leading manufacturing corporations is shown in the accompanying chart based upon our annual tabulations of published statements. For the group as a whole the net profit margin averaged 5.4 cents per sales dollar in 1952, compared with 6.2 cents in 1951, and was the lowest since 1945. Rate of return on net assets averaged 12.3 per cent in 1952, compared with 14.4 per cent in 1951 and was the lowest since 1946.

One of the outstanding features of these reports is the extent to which profit margins were squeezed by the pressure of rising labor and



Average Percentage Profit Margin on Sales and Rate of Return on Net Assets of Leading Manufacturing Corporations

other costs against fixed O.P.S. ceilings, as well as by stiff competition, strikes, raw material shortages, overproduction, and inventory write-downs. The relative changes in sales and income appear to have followed a fairly regular pattern, where an increase in sales was accompanied by a smaller increase (if any) in net income, or a decrease in sales brought a sharper decrease in net income.

This relationship is summarized in the following analysis of 1,335 manufacturing corporations whose available sales figures show changes for 1952 over 1951 of not more than 30 per cent either up or down. It shows the number of companies in each of twelve classifications by the percentage changes in sales, the median or middle change in sales for each group, and the corresponding median change in net income.

Relative Changes in Sales and Net Income, Year 1952 as Compared with 1951, of 1,335 Manufacturing Corporations Which Reported Sales Changes Ranging from 30 Per Cent Increases to 30 Per Cent Decreases

Number of Companies	Changes in Sales Range	Changes in Sales Median	Changes in Net Income Median
36	+26 to 30%	+28%	+11%
50	+21 to 25	+23	+ 2
78	+16 to 20	+18	— 1
119	+11 to 15	+13	— 2
171	+ 6 to 10	+ 8	— 5
268	+ 0 to 5	+ 3	— 9
215	— 0 to 5	— 3	—15
163	— 6 to 10	— 8	—25
106	—11 to 15	—13	—28
67	—16 to 20	—18	—35
38	—21 to 25	—23	—45
24	—26 to 30	—28	—48

The figures cover only the magnitude of the changes and the number of companies experiencing them, with no weighting for relative size of companies. Thus they differ from composite dollar figures, whose totals are heavily weighted by the biggest producers. The use of a median or middle change in net income for each group, rather than an arithmetic average of all changes, helps to minimize the effects of the extreme and often erratic fluctuations, both up and down, found in the actual experience of individual

companies. The median in each group does not purport to represent the "typical" change, but simply the mid-point of all the changes experienced by the group.

It will be seen that the greatest concentration of companies was in the four center groups having sales increases or decreases up to 10 per cent, which accounted for over three-fifths of the total number analyzed. For the group having sales increases of 6 to 10 per cent, the median change in net income was down 5 per cent. In other words, of this group of 171 companies, as many had decreases of 5 per cent or more as had decreases of 5 per cent or less.

In the group where sales increased by less than 5 per cent, the median net income decreased 9 per cent. Where sales decreased by less than 5 per cent, the median net income decreased 15 per cent. Where sales decreased 6 to 10 per cent, the median net income decreased 25 per cent. Throughout the twelve groups, from top to bottom, the figures show a persistent tendency for net income to move less favorably than sales. Under the conditions prevailing last year the average manufacturer had to achieve a substantial gain in sales merely to maintain the same net income.

These simple comparisons, of course, throw little light on the whys and wherefores behind the changes, which reflect an almost infinite variety of forces that are themselves changing constantly. The diverse factors determining earnings affect every company differently.

Nevertheless, the pronounced lag last year of net income behind sales as shown by this broad sample of published reports suggests the problems calling for careful study by industrial management in charting policies on production, selling, and finance. The 1952 record emphasizes the need for continued efforts not only to expand sales, but also to strengthen control over costs.

Another Commodity Headache

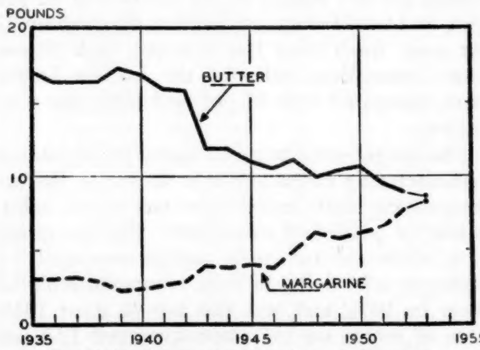
The current accumulation of surplus butter under the government price support program brings back unhappy memories of the fiasco with potato price supports only a few years ago. As recently as 1950, housewives will recall that food markets had few potatoes for sale, and those under-sized and low-grade, while potatoes of better quality, acquired by the Commodity Credit Corporation at the taxpayers' expense, were being destroyed or sold back to farmers at a nominal price for use as livestock feed. Public indignation was aroused and the end result was the collapse of the scheme. Potatoes today are bought and sold in a free market.

Now the Commodity Credit Corporation is acquiring large stocks of butter. Since late November, when the current buying program started, government butter purchases, during this non-flush producing period, have exceeded 132 million pounds. While some of this butter has been disposed of or set aside for the school lunch program, latest reports indicate that government holdings run beyond 110 million pounds. The normal seasonal expansion of butter output promises an even more rapid accumulation in the weeks ahead.

Needed Adjustments Prevented

This butter accumulation is the consequence of a high price support policy when free market forces indicate that lower production of butter is in order. Butter, of course, is a commodity which has lost ground to margarine, both in production and in consumption. Since the pre-World War II years, butter output has declined about one third, while margarine production has more than tripled. In fact, 1952 margarine output, some 24 per cent over 1951, exceeded creamery butter production for the first time.

While creating the problem of disposing of large stocks, the Department of Agriculture, by supporting prices at 90 per cent of parity, is also accentuating the butter problem by discouraging its use. With a lower price, some additional butter would undoubtedly find a market. On the other hand, consumption of colored margarine, which on July 1 will be legalized for sale in all but three states, is being accelerated by its relatively cheap price, retailing from 25 to 30 cents per pound, about one third the price of butter. Continuation of a price spread of this size will further encourage the use of margarine at butter's expense.



Per Capita Consumption of Butter and Margarine

More important in the long run, high butter supports are deferring desirable shifts in production and marketing. For example, reduced output of cream for butter manufacture would

permit improvement in the quantity and quality of fluid milk to meet the needs of a growing population.

Thus, barring a drouth or other national emergency, all indications point to butter being priced more and more out of its former market and the Government being forced to carry forward purchases up to a total which before the end of the summer may exceed 250 million pounds. Like potatoes in 1950, these stocks will be difficult to dispose of without large losses.

Despite these prospects, Secretary Benson has decided to continue support of dairy products at 90 per cent of parity for another year. In support of this action he stated in the April issue of the Farm Journal:

> Dairy farmers' costs are pegged high. Feed has a support price under it — a rigid price. [Corn is supported at 90 per cent of parity while the rate on other feed grains is 85 per cent.] Labor is scarce and costly. There is no immediate way for dairymen to get those costs down. Leaders of the industry merely asked for time. 'Give us a year', they said, 'and we believe we can work out something requiring but little government help.'

Mr. Benson fully realizes the difficulties ahead. On March 5 in a letter to Senator George D. Aiken, Chairman of the Senate Committee on Agriculture and Forestry, and to Congressman Clifford R. Hope, Chairman of the House Committee on Agriculture, he declared:

> Despite our decision in the Department that dairy supports should be continued another 12 months at the 90 per cent level, I nevertheless have also tried to make it plain that I have misgivings as to any program which simply accumulates surpluses without any real methods of disposal in sight.
>
> This dairy decision does not set a precedent for any other commodity, or for dairy products for another year for that matter. It is my firm belief that each case must be decided upon its own merits, further reinforced by the strong feeling that farmers need in every case seriously to consider as to whether continued high inflexible supports may not in fact help destroy the very markets upon which they must always depend for their livelihood.

Beef Price Supports Rejected

Whereas the dairy industry was able to secure high level supports for another year, it is encouraging to note the opposite attitude of a Livestock Industry Committee which studied the current beef cattle situation, which is plagued by surplus numbers and prices about 36 per cent below a year ago. This committee reported:

> Every possible approach to a solution of the problem was examined, including the idea of Government subsidies and supports but [we] rejected this approach as offering, at best, only a temporary relief for those now in financial difficulty. It was the committee's opinion that Government interference at this time would only further complicate the problems and delay the establishment of a sound operating program for the industry.

The committee also indicated its belief that the current price squeeze was confounded and aggravated by the present rigid high price supports on basic commodities, particularly feedstuffs. As a result, it recommended that the whole support program be re-examined and more flexibility brought into it.

Nevertheless, the committee also urged the use of as much beef as possible by the armed services and the school lunch program. Apparently, the Department of Agriculture has accepted this idea in order to help stabilize the market. Recently it has offered to buy unspecified quantities of beef at prices which would reflect no more than 90 per cent of parity for beef cattle.

Recent exports of cattle from this country to Canada, the first in more than five years, indicate the value of a free market in meeting demand. Had beef cattle prices been supported at rigid high levels, these exports might not have been possible and present beef surpluses would be even larger. The future of many dairy products, especially butter, would be brighter if they also were freed of high and rigid price supports.

What Price Gold?—Debate Continued

The response accorded the article on "The Price of Gold" in the January issue of this Letter has been evidence of the continuing and widespread interest in this subject. In that article we undertook to discuss the merits of proposals that the U.S. Treasury price for gold be raised above the present $35 an ounce, and concluded that such an increase would fall far short of yielding the advantages claimed by its proponents towards solving world currency difficulties and, moreover, would not be in the interests of the United States.

Since then letters from readers and comments in the press and financial journals, both here and abroad, have attested to the liveliness of the gold price controversy. Opinions have ranged on both sides of the question, with those in this country generally tending to support our position and those abroad tending to be critical, though the pattern is by no means uniform.

Advocates of a higher gold price, as explained in our article, base their case largely on an alleged shortage of the metal for monetary purposes. It is claimed that since the U.S. Treasury gold price has stood still since the 1930s, while other prices and costs have more than doubled, world gold reserves are no longer large enough, at current valuations, to support domestic credit structures and at the same time provide adequate cushion against sudden swings in the balances of international payments.

To correct this situation, build international liquidity, and prepare the way for currency convertibility, an advance in the price paid for gold is held by its advocates to be essential. The dollar value of existing monetary stocks would be increased and also, it is argued, new gold production would be encouraged and private gold holding discouraged.

In our article opposing a higher gold price, we took the position that the gains thereby to foreign exchange reserves of other countries would be comparatively small, and their distribution uneven and haphazard; that raising the price of gold would do nothing to correct underlying causes of trade disequilibrium; that if chronic causes of unbalance were removed, the world trade system would operate smoothly on relatively small gold reserves; but that as long as these chronic distortions go uncorrected, the gains to international liquidity resulting from a higher gold price would be soon dissipated.

Did Gold Shortage Cause the Depression?

With respect to the argument that the gold price has remained stationary while general prices and costs have risen greatly, we pointed out that, while this is indeed true as compared with the 1930s, comparison with 1926 shows that the U.S. gold price and the U.S. wholesale commodity price index have both gone up about the same amount – some 70 per cent. To this the rejoinder has been that taking the relationship of gold and commodity prices now and in the '20s as the guide fails to recognize that it was primarily a shortage of gold at that time that brought on the 1929 collapse. As an article in The Times Review of Industry (London), in commenting on our 1926 comparisons, put the case:

> This argument . . . seems to miss the essential point that during the 1920s a shortage of gold appeared to exercise a general deflationary pressure on credit and prices, until in the end the world's economy gave way and plunged into the abyssmal depression of 1930 and 1931. It was not until all countries increased the price of gold in terms of their own currencies in 1931 and 1932 that the world emerged from the depression.

The importance attached to this gold-shortage theory of the depression, with corresponding emphasis placed on the step now held necessary to avert repetition of the 1929-32 episode, raises a question as to the supporting evidence.

This is not the place to attempt an extended exploration of the question of the adequacy of gold stocks in the '20s, and fortunately there is authoritative testimony on the subject. We refer to the report of the Gold Delegation of the Financial Committee of the League of Nations, rendered in June 1932. That Delegation was composed of a group of monetary experts of twelve different countries, including the United States, appointed in 1929 and charged to "examine into and report upon the causes of fluctuations in the purchasing power of go' l and their effect upon the economic life of the nations." We quote from the final report as follows:

> Before proceeding further in our analysis of the problem of the gold supply, we wish at this point to record our opinion that the world's total stock of monetary gold, apart from any considerations as to its distribution among different countries, has at all times in recent years been adequate to support the credit structure legitimately required by world trade and that the rapid decline in prices, which began in 1929, cannot be attributed to any deficiency in the gold supply considered in this sense. During the six years from the end of 1925 to the end of 1931, the world's central gold reserves increased from about $9,150 million to about $11,350 million, or at an average rate of 3⅜ per cent per annum. Since this rate is not lower than the generally accepted normal rate of growth of production and trade in the gold-using countries as a whole, and since, in addition, certain economies were made in the use of gold, at any rate in the earlier part of the period considered, there seems to be little ground for believing that the total supplies of gold available for monetary use have not been sufficient to meet all reasonable demands.

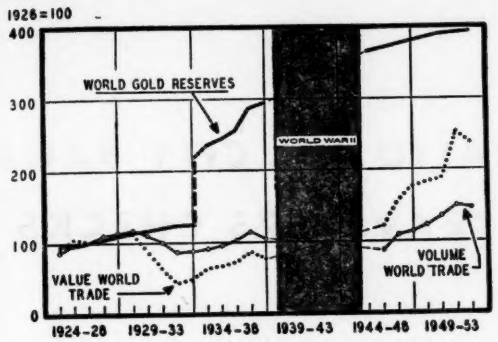
In other words, what the Gold Delegation found was that the trouble then (as now) lay not in any overall lack of monetary reserves, but in their maldistribution. This, in turn, proceeds from disequilibrium in the underlying trade and capital movements, which we have stressed as the basic source of present difficulties.

In the '20s, it is interesting to recall, one of the causes of maldistribution of gold was the heavy absorption by France, following stabilization of the franc at a low level in 1926 and financial reforms instituted by the strong Poincare Government. Another cause was our own rampant stock market, which sucked in funds from all over the world. The reader may judge for himself how much good raising the price of gold would have done under such circumstances.

Gold Reserves and Trade Since the '20s

The accompanying diagram shows the trend of world gold reserves valued in dollars, compared with the quantity and value in dollars of world trade since the 1920s when the Gold Delegation says the monetary stocks were "adequate." The gold figures are from the Federal Reserve Board and the trade figures from the League of Nations and the United Nations. They are given in terms of index numbers based on 1926 as 100.

It will be seen that, if we accept the Gold Delegation's judgment as to the sufficiency of gold stocks in the '20s, the evidence (even after allowance for unavoidable inaccuracies in computing world trade data) still affords no support for the thesis of "there not being enough gold to go around." Instead of the monetary value of the gold stocks having lagged behind



Trend of World Gold Reserves Compared with Volume and Value of World Trade. Indexes Based on 1926 as 100.

trade growth, as charged, the reverse appears to have been the case. Those who measure the changes from the '30s do so from a period when trade and commodity prices were still depressed, whereas the price of gold had just been increased. While the value of world trade has risen quite sharply since the end of the war, it has not yet caught up to the increase in gold reserves, due to the lag in trade volume.

All this, of course, is not to ignore the strains produced by the present uneven distribution of gold in relation to needs. But that, to repeat, is another problem.

Meanwhile, world gold production in 1952 appeared to be resuming the moderate recovery from the 1945 postwar low that was interrupted in 1951. That the $35 price is not standing wholly in the way of gold mining development is shown by the opening of new gold fields in the Orange Free State of South Africa, said to be the most important to come to production since the Main Reef of the Central Rand was discovered in 1886. New mines are also being developed in two other fields, the Far West Rand and the Klerksdorp region of Transvaal.

At the same time, there is a question how much more rapidly output would be expanded even by a higher price. This is partly because of the tendency of the industry to take advantage of an increased price to work the lower grades of ore and thus prolong the life of the mines. But more largely it is because of the acute labor shortage prevalent in most of the mining areas. The situation now is quite different from what it was at the time of the price increases of the early '30s when labor was plentiful; and even then the expansion of output came gradually and did not reach maximum until 1940.

Other Points of Disagreement

Space is lacking to discuss other exceptions taken to our article. Many of them, recognizing that Congress is in a mood to balance the budget and ease the tax burden, commend a write-up in the valuation of the U.S. gold stock as a way to provide a costless "kitty" to help other nations balance up their accounts. This has a seductive appeal. But, stripped to essentials, it is the old idea — with some gold embroidery — of printing money to spend. If this were a proper way to balance up accounts, the U.S. Congress would have no need to struggle with expenditure reductions or to levy the taxes it does toward balancing the budget here. What is sauce for the goose should be sauce for the gander.

In answer to our fear of the inflationary effects of a higher gold price, some of our critics point out that the "profits" of gold upvaluation could be held immobilized — just as they were created — by bookkeeping transactions. If that could be completely achieved, worldwide, it would render the whole enterprise quite useless. The practical likelihood is that write-ups of gold values would give impulse to a new inflationary binge. The dilemma of the scheme is that a moderate gold write-up would afford little gain to international liquidity, while a large write-up would increase correspondingly the scope for inflation.

Prudent, industrious, saving people have suffered incalculable losses these past decades from such devices. Modern industrial civilization cannot progress without money in which bonds and contracts can be negotiated and business transacted with reasonable confidence. Schemes that give new play for unbalanced international accounts postpone the time when paper currencies and claims will be fully and generally entitled to that confidence.

Only Congress Can Change Dollar Gold Parity

In all the theorizing about the price of gold, it would be well not to overlook the very practical fact that only an act of Congress can change the gold parity of the dollar. Not only has the President's former power to re-value lapsed long since, but — more important — in the Bretton Woods Agreements Act of July 31, 1945, whereby the United States joined the International Monetary Fund, it was specifically stated that:

> Unless Congress by law authorizes such action, neither the President nor any person or agency shall on behalf of the United States . . . propose or agree to any change in the par value of the United States dollar.

In view of this country's ample gold stock, its experience with inflation, and the commitments by the new Administration to protect the buying power of the dollar, it seems inconceivable that any alteration of the gold parity of the dollar would be approved.

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